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Bankruptcy Court Finds No Subject Matter Jurisdiction Over Post-Confirmation Declaratory Judgment Action

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How far will the bankruptcy court go in exercising post-confirmation jurisdiction in an adversary action based on a pre-petition state law claim? The answer, as shown in the case [*In re Washington Mutual \(Washington Mutual v. XL Specialty Insurance\)*](#), Bankr. Del., Oct. 4, 2012, is not far at all.

Washington Mutual Inc. (WaMu) filed an adversary action against the issuers of 12 liability insurance policies affording liability coverage for WaMu's directors and officers. (The WaMu Liquidating Trust was subsequently substituted in place of WaMu.) WaMu alleged breach of contract and breach of the implied duty of good faith and fair dealing and sought declaratory relief and attorney fees for the insurers' failure to pay defense costs and denial of coverage for a demand letter made by WaMu against its former officers and directors. The complaint was filed after confirmation of WaMu's Chapter 11 plan and one day before the plan's effective date. In the plan, WaMu agreed to establish a contingent reserve of \$65 million for D&O claims, with \$55 million set aside for defense costs associated with the claims.

The defendants moved to dismiss the complaint on several grounds, including the absence of subject matter jurisdiction. As the court and parties acknowledged, a bankruptcy court may exercise jurisdiction over four categories of matters: cases under Title 11; proceedings arising under Title 11; proceedings arising in a case under Title 11; and proceedings related to a case under Title 11. A declaratory judgment action to determine insurance coverage on a pre-petition state law contract does not involve the bankruptcy petition itself or any steps within the bankruptcy case itself and therefore is not a case under Title 11, a proceeding arising under Title 11, or a proceeding arising in a case under Title 11. The breach of contract and fiduciary duty claims are ordinary state law claims of the type brought in state courts with no connection to the Bankruptcy Code or a bankruptcy case. Therefore, the court concluded, it had at most "related to" jurisdiction over those counts. However, after confirmation of a Chapter 11 plan, the scope of the bankruptcy court's "related to" jurisdiction is limited. Post-confirmation, a bankruptcy court only has jurisdiction over a claim that has a "close nexus" to the bankruptcy plan or proceeding, such as one that affects the interpretation, implementation, consummation, execution or administration of the plan or incorporated litigation trust agreement.

The trust argued the claims bore a "close nexus" to the bankruptcy case because its creditors would receive more money sooner from the funds held in reserve if the defendants were required to pay the D&Os' defense costs and the \$55 million reserve could be released. Although the trust conceded the mere possibility of a gain or loss of trust assets was insufficient to confer post-confirmation bankruptcy jurisdiction over related matters, it argued the impact on creditors' claims and the

existence of the plan reserve were contributing factors that met the "close nexus" standard. The court disagreed. The plan provided payment in full with interest to most unsecured creditors. Even in a worst-case scenario, where the trust was forced to pay the D&Os' defense costs without insurance coverage, creditors under the plan would largely be unaffected. The release of the reserve would provide only a de minimis additional recovery to creditors. Accordingly, the court found that the assets of the trust would not be augmented or diminished significantly by any decision on the extent of coverage. It is unclear from the opinion whether the result would have been different had the potential impact of the litigation been more significant to the trust, but it is doubtful since the court emphasizes that if the possibility of a gain or loss of trust assets were sufficient to confer "related to" jurisdiction, the result would be to broaden the scope of bankruptcy court jurisdiction well beyond congressional limits.

The trust also argued that the suit was related to the plan and confirmation order. In denying coverage, the defendants invoked the "insured versus insured exclusion" in the policies. The trust argued that since the confirmation order provided that the creditors' committee was authorized to prosecute the D&O claims, the bankruptcy court had to interpret its own order to conclude that the "insured versus insured exclusion" was not applicable. Again, the court disagreed. Whether or not the trust has a valid claim based on the interpretation of the plan and confirmation order, that assertion is not the type of plan interpretation sufficient to confer subject matter jurisdiction, because the interpretation is not essential to the integrity of the plan and its implementation, and the plan and confirmation order can be interpreted by other courts of competent jurisdiction that are both capable of doing so and routinely engage in such interpretation.

Finally, the trust argued that the bankruptcy court had jurisdiction because the plan expressly provided that the bankruptcy court would retain jurisdiction "to determine any and all motions, adversary proceedings, applications, and contested or litigated matters that may be pending on the effective date." The court again disagreed, stating that debtors cannot be permitted to write their own jurisdictional ticket by merely including a generic retention clause in the confirmation plan. Rather, to have a sufficiently close nexus to retain post-confirmation jurisdiction, a plan must specifically describe an action over which the court had "related to" jurisdiction pre-confirmation and expressly provide for the retention of such jurisdiction to liquidate that claim for the benefit of the estate's creditors. Otherwise, there would be unending jurisdiction post-confirmation. Moreover, even when a plan clearly and unambiguously retains jurisdiction for a specific cause of action, the court will not have post-confirmation jurisdiction unless a substantial nexus is established. Because there was no close nexus to the plan and no specific reference to the action in the plan, the court had no subject matter jurisdiction over the breach of contract and breach of fiduciary duty claims. As a result, the motion to dismiss those claims was granted. (The court also dismissed the counts for a declaratory judgment on the ground that the underlying claims were too hypothetical and speculative to constitute an actual controversy and therefore there was no "case of actual controversy" before the court.)

The opinion of the court clearly and succinctly explains the limitations on the bankruptcy court's subject matter jurisdiction over post-confirmation actions and illustrates the application of those limits to a declaratory judgment action to determine insurance coverage on a pre-petition state law contract. While the opinion does not break new ground, it serves to underscore two very important principles: First, gain or loss to a post-confirmation trust is not a sine qua non for bankruptcy court jurisdiction; and second, the recital of retention of jurisdiction in the confirmation plan alone — either generally or with respect to a specific claim — cannot create bankruptcy court jurisdiction. The court's recognition of the limits of its jurisdiction is also a continuing rebuttal to those who criticize the Delaware court in particular and would seek to change the Bankruptcy Code to limit further the cases that can be brought here.

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